THE RELATIONSHIP BETWEEN STATE AND LOCAL TAX BURDENS AND SPENDING BY STATE AND LOCAL GOVERNMENT

A study Prepared by the Staff

Of The

Joint Economic Committee

July 26, 1985

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Over the last several years, there have been a number of proposals calling for changes in the Federal revenue code which have included either the elimination or alteration of the deduction for taxes paid to state and local governments. These have included the Kemp/Kasten "FAST Tax" and the Administration's tax proposals, "Treasury I" and "Treasury II." A heated controversy has developed in recent months over whether the elimination of this deduction would increase or decrease fairness in the tax code.

A central argument in that debate has been whether or not the deduction subsidizes states that have high levels of state and local government spending. The "high-tax states," or states in which taxpayers get the largest Federal deductions for state and local taxes paid, have been labeled as "neosocialist" by a senior White House aide. Some proponents of eliminating the deduction have also implied that taxpayers in high-tax states use state and local government and the deduction to shelter income.

All of these arguments seem to be based on the premise that the variation in tax burden by state is attributable to variations in spending by state. In short, that high-tax states spend significantly more than low-tax states. This report examines the validity of that premise.

Last month, Arthur Andersen & Co., at the request of the Joint Economic Committee, examined state and local tax laws

across the country to determine how much the total tax burden for an upper middle-income family might vary from one state to the next when Federal, state, and local taxes were added together. (Only state and local taxes which are deductible under Federal tax laws were included. Nondeductible taxes, such as license fees, excise and amusement taxes, and user fees, are not counted.) It further examined how much the variation would be if the Administration tax reform plan became law.

It was assumed that the family in the study had a comparatively high level of taxable income, $50,000 a year. The study gives an accurate picture of the relative tax burden by state for a family at that income level. It cannot be stated, however, that the study would reflect the relative tax burden among the states for families at all income levels. Relative state tax burdens will vary by income level, family spending patterns, ownership of real and, in some instances, personal property, and by family size.

Still, the Andersen study eliminates a number of extraneous variables, such as differences in average income and in income distribution by state, which are inherent in other data that could be used in comparing state tax burdens. The Andersen data provide the actual tax payments required of a taxpayer at a designated income level in each of the 50 states. It is, to the knowledge of the Committee staff, the only data of this type and is the best available data for the purposes of comparing state and local tax burdens.

The lowest tax state in the study was Alaska. In Alaska, the hypothetical family would pay $650 a year in combined state and local taxes. The highest state was Wisconsin, where the same family would pay $7,250. The combined state and local tax bill for each state is displayed in column A of Table I.

Spending by state and local governments is more easily measured. Column B of Table I lists direct general expenditures per capita for 1981 as reported by the U.S. Statistical Abstract.

TABLE I

STATE	COLUMN A * TAX STATE & LOCAL	COLUMN B ** SPENDING STATE & LOCAL
ALASKA	$650	$7,211
WYOMING	$900	$2,783
NEVADA	$1,000	$2,075
TEXAS	$1,250	$1,499
WASHINGTON	$1,600	$2,083
FLORIDA	$1,700	$1,469
TENNESSEE	$1,800	$1,398
LOUISIANA	$2,050	$1,808
SOUTH DAKOTA	$2,350	$1,715
ALABAMA	$2,500	$1,448
NEW HAMPSHIRE	$2,550	$1,512
CONNECTICUT	$2,600	$1,715
NORTH DAKOTA	$2,650	$1,947
NEW MEXICO	$2,850	$1,894
OKLAHOMA	$3,150	$1,583
ARIZONA	$3,200	$1,748
MISSISSIPPI	$3,200	$1,487
COLORADO	$3,500	$1,788
KANSAS	$3,500	$1,775
KENTUCKY	$3,550	$1,495
WEST VIRGINIA	$3,650	$1,625
MISSOURI	$3,700	$1,414
MONTANA	$3,750	$1,892
ILLINOIS	$3,800	$1,761
PENNSYLVANIA	$3,900	$1,594
CALIFORNIA	$4,150	$2,100
GEORGIA	$4,150	$1,538
INDIANA	$4,200	$1,400
OHIO	$4,350	$1,572
ARKANSAS	$4,400	$1,303
VIRGINIA	$4,450	$1,601
NEBRASKA	$4,500	$1,665
SOUTH CAROLINA	$4,500	$1,435
UTAH	$4,500	$1,704
IDAHO	$4,600	$1,501
VERMONT	$4,600	$1,747
NEW JERSEY	$4,700	$1,886
HAWAII	$4,750	$2,181
NORTH CAROLINA	$4,800	$1,421
MASSACHUSETTS	$4,900	$1,941
MARYLAND	$5,100	$1,918
IOWA	$5,350	$1,753
MAINE	$5,500	$1,533
OREGON	$5,600	$2,102
RHODE ISLAND	$5,850	$1,941
DIST OF COLUMBIA	$5,900	$2,982
MICHIGAN	$6,250	$1,962
DELAWARE	$6,300	$2,060
NEW YORK	$6,700	$2,419
MINNESOTA	$6,900	$2,102
WISCONSIN	$7,250	$1,929

* May 31, 1985 Study by Arthur Andersen & Co. for the Joint Economic Committee, Exhibit 2, "Detail of State and Local Tax Cost."

** 1984 U. S. Statistical Abstract.

The highest spending state, according to these numbers, is Alaska, the lowest tax state in the Andersen study, with expenditures of $7,200 per person. That is more than 300 percent above the national average of $1,790. Further analysis of Alaska spending patterns indicate that it leads the nation in virtually every category of state and local spending. Per pupil expenditures in education were more than $6,000 or almost three times the national average. AFDC welfare payments were 60 percent higher in Alaska than in New York.

While no other state spent nearly as much per capita as Alaska, the second highest spending state also turns out to be the second lowest taxing state. Wyoming, where the hypothetical family in the Andersen study pays $900 a year in taxes, spends 55 percent more per capita than the national average. Nevada, the third lowest tax state in the Andersen study, ranks among the top 10 states in per capita spending.

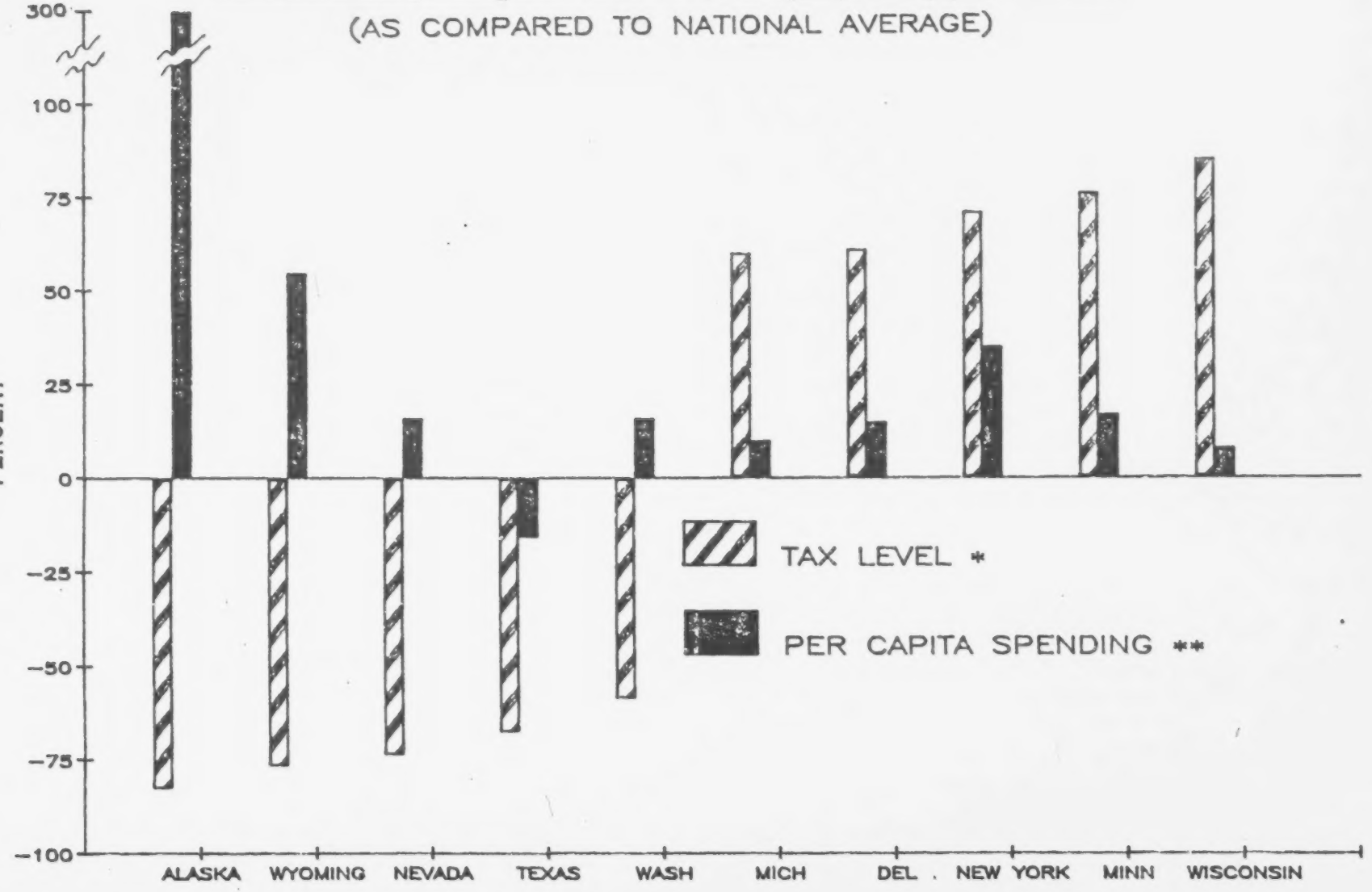
Surprisingly, a comparison of the tax numbers in column A and the spending numbers in column B by the Senate Computer Center actually found a slightly negative correlation between the level of Federally deductible taxes which a family with a taxable income of $50,000 a year would pay and per capita spending on state services. In other words, lower tax states, on the whole, tended to be slightly higher spenders than high-tax states.

The absence of a positive relationship between taxing and spending is particularly pronounced for states at the two ends of the tax spectrum.

STATE AND LOCAL TAXES VS. STATE AND LOCAL SPENDING

(AS COMPARED TO NATIONAL AVERAGE)

ILLUSTRATION I



*Based on Arthur Andersen Study. **State & local per capita spending, 1984 Statistical Abstract

As Illustration I indicates, the five highest tax states do tend to be above the national average in per capita spending by state and local governments. But their spending levels are considerably below the spending levels of the lowest tax states. The average per capita spending among the five low-tax states was 49 percent above the average for the five highest tax states.

The state with the highest tax levels, Wisconsin, ranks 15th in state and local spending, only 8 percent above the national average. Wisconsin spends less per capita than four of the five lowest tax states.

Furthermore, Wisconsin, like many high-tax states, does poorly in the redistribution of Federal tax dollars. Wisconsin gets only 82 cents in Federal spending (spending offset by revenues) returned to the state for every dollar in taxes paid to Washington. Of the five highest tax states, none gets back more than 92 cents on the dollar.

When all government expenditures are considered (Federal, state, and local), Wisconsin, the state in which the hypothetical family would pay the most both in state and local taxes and in combined Federal, state, and local taxes (36 percent more than Alaska under current law and 76 percent more under the Administration's tax plan), ranks 37th in total government per capita spending. Michigan, the fifth highest tax state, ranks 32nd in total government spending.

Based on the data in this analysis, there is no evidence that the level of tax burden borne by an individual taxpayer in a

state is related to the level of spending in that state. While these data are not of sufficient quality to say that a negative relationship, as found in this analysis, is accurate or even to say definitively that a positive relationship does not exist, it is sufficient to state that the large disparities that exist among states in the level of tax burden is not primarily attributable to spending patterns.

The analysis suggests that states which are popularly considered "high-tax" are only so in the degree to which they are forced to focus their tax burden on state residents.

While clearly no governor or legislature would choose to focus the state's tax burden on the state's residents, there appear to be widely differing levels of opportunity for each state to transfer its tax burden to individuals outside the state. The primary, but certainly not the only, example of this is the severance tax on oil and gas which goes into the treasury of a producer state but is paid by consumers wherever the oil or gas is used. Restaurant, hotel, and amusement taxes in states and localities with heavy out-of-state tourism industries are a second example. Legalized gambling of various forms is a third.

Arguments in support of the elimination of the deduction for taxes paid to state and local governments which link the very high variations in state and local tax burdens to state and local government spending thus are based on a premise that cannot be substantiated.

JOINT ECONOMIC COMMITTEE * PAUL MANCHESTER 16:18 TUESDAY, JULY 23, 1985
STATE TAX AND EXPENDITURE DATA
ALL STATES

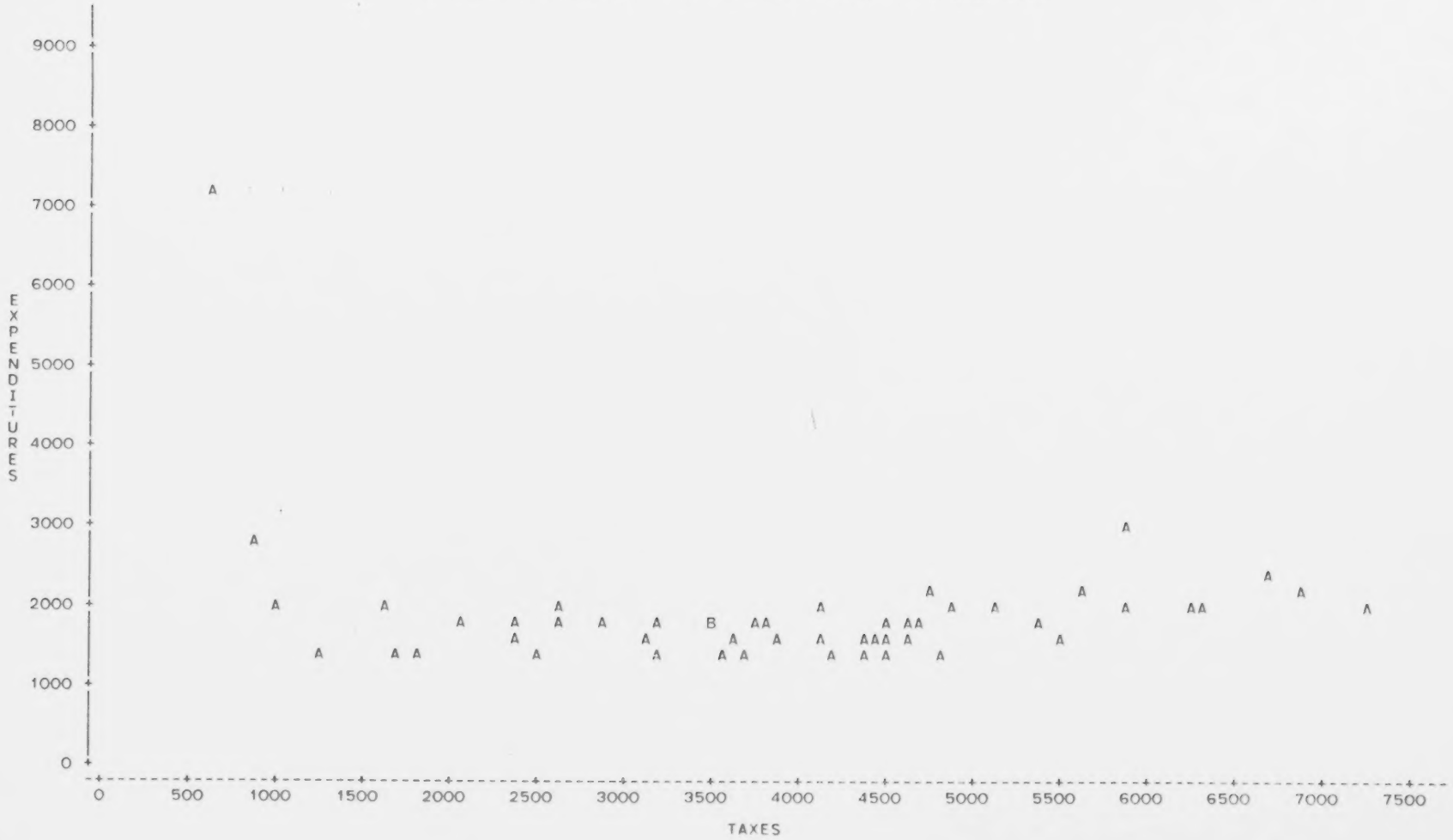
STATE	X TAXES	Y EXPENDITURES
ALABAMA	2500	1448
ALASKA	650	7211
ARIZONA	3200	1748
ARKANSAS	4400	1303
CALIFORNIA	4150	2100
COLORADO	3500	1788
CONNECTICUT	2600	1715
DELAWARE	6300	2060
DISTRICT OF COLUMBIA	5900	2982
FLORIDA	1700	1469
GEORGIA	4150	1538
HAWAII	4750	2181
IDAHO	4600	1501
ILLINOIS	3800	1761
INDIANA	4200	1400
IOWA	5350	1753
KANSAS	3500	1775
KENTUCKY	3550	1495
LOUISIANA	2050	1808
MAINE	5500	1533
MARYLAND	5100	1918
MASSACHUSETTS	4900	1941
MICHIGAN	6250	1962
MINNESOTA	6900	2101
MISSISSIPPI	3200	1487
MISSOURI	3700	1414
MONTANA	3750	1892
NEBRASKA	4500	1665
NEVADA	1000	2075
NEW HAMPSHIRE	2350	1512
NEW JERSEY	4700	1886
NEW MEXICO	2850	1894
NEW YORK	6700	2419
NORTH CAROLINA	4800	1421
NORTH DAKOTA	2650	1947
OHIO	4350	1572
OKLAHOMA	3150	1583
OREGON	5600	2102
PENNSYLVANIA	3900	1594
RHODE ISLAND	5850	1941
SOUTH CAROLINA	4500	1435
SOUTH DAKOTA	2350	1715
TENNESSEE	1800	1398
TEXAS	1250	1499
UTAH	4500	1704
VERMONT	4600	1747
VIRGINIA	4450	1601
WASHINGTON	1600	2083
WEST VIRGINIA	3650	1625
WISCONSIN	7250	1929
WYOMING	900	2783

APPENDIX -- Calculations by Senate Computer Center

JOINT ECONOMIC COMMITTEE * PAUL MANCHESTER
PLOT OF EXPENDITURES VS. TAXES
ALL STATES

16:18 TUESDAY, JULY 23, 1985

PLOT OF EXPEND*TAXES LEGEND: A = 1 OBS, B = 2 OBS, ETC.



JOINT ECONOMIC COMMITTEE * PAUL MANCHESTER 16:18 TUESDAY, JULY 23, 1985
UNIVARIATE STATISTICS ON TAXES AND EXPENDITURES
ALL STATES

(6)

	VARIABLE	LABEL	N	MEAN	STANDARD DEVIATION	MINIMUM VALUE	MAXIMUM VALUE	STD ERROR OF MEAN	SUM	VARIANCE	C.V.
X	TAXES	TAXES	51	3909.803922	1603.340875	650.000000	7250.000000	224.5126295	199400.000	2570701.96	41.008
Y	EXPEND	EXPENDITURES	51	1890.470588	830.382258	1303.000000	7211.000000	116.2767738	96414.000	689534.69	43.925

DEP VARIABLE: EXPEND EXPENDITURES

SOURCE	DF	SUM OF SQUARES	MEAN SQUARE	F VALUE	PROB>F
MODEL	1	1164461	1164461	1.713	0.1967
ERROR	49	33312274	679842		
C TOTAL	50	34476735			

ROOT MSE	824.526	R-SQUARE	0.0338
DEP MEAN	1890.471	ADJ R-SQ	0.0141
C.V.	43.61483		

VARIABLE	DF	PARAMETER ESTIMATE	STANDARD ERROR	T FOR HO: PARAMETER=0	PROB > |T|	TYPE I SS	TYPE II SS	STANDARDIZED ESTIMATE	TOLERANCE	VARIABLE LABEL
INTERCEP	1	2262.611	306.893	7.373	0.0001	182267831	36953366	0.000000	.	INTERCEPT
TAXES	1	-0.095181	0.072727	-1.309	0.1967	1164461	1164461	-0.183780	1.000000	TAXES

COVARIANCE OF ESTIMATES

COVB	INTERCEP	TAXES
INTERCEP	94183.29	-20.6796
TAXES	-20.6796	0.005289157

CORRELATION OF ESTIMATES

CORRB	INTERCEP	TAXES
INTERCEP	1.0000	-0.9265
TAXES	-0.9265	1.0000

OBS	ID	ACTUAL	PREDICT VALUE	STD ERR PREDICT	LOWER95% MEAN	UPPER95% MEAN	LOWER95% PREDICT	UPPER95% PREDICT	RESIDUAL	STD ERR RESIDUAL	STUDENT RESIDUAL	-2-1-0 1 2	COOK'S D
1	ALABAMA	1448	2025	154.411	1714	2335	338.911	3710	-576.658	809.938	-0.712	*	0.009
2	ALASKA	7211	2201	263.694	1671	2731	461.127	3940	5010	781.222	6.413	******	2.343
3	ARIZONA	1748	1958	126.471	1704	2212	281.710	3634	-210.031	814.768	-0.258		0.001
4	ARKANSAS	1303	1844	120.835	1601	2087	169.173	3518	-540.813	815.623	-0.663	*	0.005
5	CALIFORN	2100	1868	116.771	1633	2102	194.133	3541	232.392	816.215	0.285		0.001
6	COLORADO	1788	1929	119.241	1690	2169	255.297	3604	-141.476	815.858	-0.173		0.000
7	CONNECTI	1715	2015	149.680	1714	2316	331.117	3699	-300.139	810.826	-0.370		0.002
8	DELAWARE	2060	1663	208.680	1244	2082	-46.217	3372	397.031	797.681	0.498		0.008
9	DISTRICT	2982	1701	185.148	1329	2073	2.839	3399	1281	803.469	1.594	***	0.067
10	FLORIDA	1469	2101	197.885	1703	2498	396.810	3805	-631.803	800.427	-0.789	*	0.019
11	GEORGIA	1538	1868	116.771	1633	2102	194.133	3541	-329.608	816.215	-0.404		0.002
12	HAWAII	2181	1810	130.629	1548	2073	132.892	3488	370.500	814.112	0.455		0.003
13	IDAHO	1501	1825	125.896	1572	2078	148.632	3501	-323.777	814.857	-0.397		0.002
14	ILLINOIS	1761	1901	115.733	1668	2133	227.738	3574	-139.922	816.363	-0.171		0.000

JOINT ECONOMIC COMMITTEE * PAUL MANCHESTER 16:18 TUESDAY, JULY 23, 1985
REGRESSION OF TAXES ON EXPENDITURES
ALL STATES

OBS	ID	ACTUAL	PREDICT VALUE	STD ERR PREDICT	LOWER95% MEAN	UPPER95% MEAN	LOWER95% PREDICT	UPPER95% PREDICT	RESIDUAL	STD ERR RESIDUAL	STUDENT RESIDUAL	-2-1-0 1 2	COOK'S D
15	INDIANA	1400	1863	117.370	1627	2099	189.205	3536	-462.849	816.129	-0.567	*	0.003
16	IOWA	1753	1753	155.887	1440	2067	67.096	3440	-.390880	809.655	-0.000		0.000
17	KANSAS	1775	1929	119.241	1690	2169	255.297	3604	-154.476	815.858	-0.189		0.000
18	KENTUCKY	1495	1925	118.385	1687	2163	250.784	3599	-429.717	815.982	-0.527	*	0.003
19	LOUISIAN	1808	2067	177.833	1710	2425	372.447	3763	-259.489	805.120	-0.322		0.003
20	MAINE	1533	1739	163.417	1411	2068	49.942	3428	-206.114	808.169	-0.255		0.001
21	MARYLAND	1918	1777	144.301	1487	2067	95.061	3459	140.814	811.800	0.173		0.000
22	MASSACHU	1941	1796	136.074	1523	2070	116.868	3476	144.778	813.220	0.178		0.000
23	MICHIGAN	1962	1668	205.661	1254	2081	-39.980	3375	294.272	798.465	0.369		0.005
24	MINNESOT	2101	1606	246.215	1111	2101	-123.380	3335	495.140	786.906	0.629	*	0.019
25	MISSISSI	1487	1958	126.471	1704	2212	281.710	3634	-471.031	814.768	-0.578	*	0.004
26	MISSOURI	1414	1910	116.461	1676	2144	237.052	3584	-496.440	816.259	-0.608	*	0.004
27	MONTANA	1892	1906	116.040	1672	2139	232.411	3579	-13.681	816.319	-0.017		0.000
28	NEBRASKA	1665	1834	123.177	1587	2082	158.966	3510	-169.295	815.273	-0.208		0.000
29	NEVADA	2075	2167	241.067	1683	2652	441.122	3894	-92.429	788.498	-0.117		0.001
30	NEW HAMP	1512	2039	161.860	1714	2364	350.369	3728	-526.935	808.482	-0.652	*	0.009
31	NEW JERS	1886	1815	128.968	1556	2074	138.170	3492	70.741	814.377	0.087		0.000
32	NEW MEXI	1894	1991	138.820	1712	2270	311.083	3672	-97.344	812.755	-0.120		0.000
33	NEW YORK	2419	1625	233.468	1156	2094	-97.189	3347	794.104	790.781	1.004	**	0.044
34	NORTH CA	1421	1806	132.369	1540	2072	127.583	3484	-384.741	813.831	-0.473		0.003
35	NORTH DA	1947	2010	147.393	1714	2307	327.173	3694	-63.380	811.244	-0.078		0.000
36	OHIO	1572	1849	119.813	1608	2089	174.228	3523	-276.572	815.774	-0.339		0.001
37	OKLAHOMA	1583	1963	127.999	1706	2220	286.001	3640	-379.790	814.530	-0.466		0.003
38	OREGON	2102	1730	168.642	1391	2068	38.351	3421	372.404	807.095	0.461		0.005
39	PENNSYLV	1594	1891	115.459	1659	2123	218.296	3565	-297.404	816.402	-0.364		0.001
40	RHODE IS	1941	1706	182.320	1339	2072	8.834	3403	235.200	804.116	0.292		0.002
41	SOUTH CA	1435	1834	123.177	1587	2082	158.966	3510	-399.295	815.273	-0.490		0.003
42	SOUTH DA	1715	2039	161.860	1714	2364	350.369	3728	-323.935	808.482	-0.401		0.003
43	TENNESSE	1398	2091	192.025	1705	2477	390.001	3793	-693.284	801.853	-0.865	*	0.021
44	TEXAS	1499	2144	225.275	1691	2596	425.962	3861	-644.634	793.154	-0.813	*	0.027
45	UTAH	1704	1834	123.177	1587	2082	158.966	3510	-130.295	815.273	-0.160		0.000
46	VERMONT	1747	1825	125.896	1572	2078	148.632	3501	-77.777	814.857	-0.095		0.000
47	VIRGINIA	1601	1839	121.958	1594	2084	164.085	3514	-238.054	815.456	-0.292		0.001
48	WASHINGT	2083	2110	203.836	1701	2520	403.497	3817	-27.321	798.933	-0.034		0.000
49	WEST VIR	1625	1915	116.993	1680	2150	241.661	3589	-290.199	816.183	-0.356		0.001
50	WISCONSI	1929	1573	268.963	1032	2113	-170.323	3315	356.454	779.424	0.457		0.012
51	WYOMING	2783	2177	247.476	1680	2674	446.981	3907	606.052	786.510	0.771	*	0.029

SUM OF RESIDUALS -2.78533E-12
SUM OF SQUARED RESIDUALS 33312274